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10701—37

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SELLAR BULLARD, AS EXECUTOR UNDER THE LAST WILL AND TESTAMENT OF CLARA R. SMITH, DECEASED

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit, entered in the above cause on May 25, 1937, reversing a decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 134–148) is reported at 34 B. T. A. 243. The opinion of the Circuit Court of Appeals (R. 165–172) is reported at 90 F. (2d) 144.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 25, 1937 (R. 172). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The decedent executed an irrevocable trust in 1932, reserving a life estate to herself. The question presented is whether Section 302 (c) of the Revenue Act of 1926, as amended by the Joint Resolution of Congress, of March 3, 1931, and by Section 803 (a) of the Revenue Act of 1932, which purports to tax such a transfer, is constitutional.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved herein will be found in the Appendix, *infra*, pp. 11–13.

STATEMENT

In 1927, the decedent had three living children, one son and two daughters, all of whom were married (R. 135). Her son, Edward A. Smith, acted as her business manager. She relied upon his judgment, suggestions, and advice (R. 137).

On March 3, 1927, she established a trust, by which she transferred to her son various securities as trustee. The instrument provided that the income should be paid to the trustor during her life, and directed the trustee, upon her death, to

separate the corpus into three separate trusts, one for each of her children. The income from such separate trust for her son was to be paid to him for life, thereafter to his widow for life, unless a child survived him, in which case other disposition was to be made of the income and corpus. The separate trusts for each of the daughters provided for the distribution of income to them for life, and thereafter the income and corpus were to be distributed in a specified manner to their children or descendants (R. 136).

Edward died without issue on December 16, 1928, leaving a widow, Virginia Winslow Smith (R. 17, 137). In 1931 the decedent became dissatisfied with the trust created in 1927, by reason of the proposed investment policy of the successor trustee. She learned then that the trust was irrevocable, contrary to the representations made to her by her son in 1927, when it was executed (R. 21, 137). A bill in equity was prepared to declare the trust void on the ground of misrepresentation and fraud in the inducement (R. 21, 116–134, 138). In order to avoid family scandal, however, she was persuaded not to go through with the proceeding (R. 138).

Upon further examination of the instrument, it was discovered that the trust, in one respect at least, violated the rule against perpetuities. Accordingly, a bill in equity was prepared and filed in the Superior Court of Cook County, Illinois, on November 25, 1931, to declare the trust void (R.

50–64, 138). In answer to the bill, Virginia Winslow Smith denied that the trust was invalid (R. 87–89), but later consented to the entry of the desired decree, upon condition that a new trust would be executed, giving her the same rights which were purported to have been given her in the 1927 instrument (R. 138). The decree of the Illinois court was accordingly entered in 1932 (R. 98–107), declaring that the trust was "wholly inoperative, void, and of no effect", and that all the assets held by the trustee were the decedent's "own, absolute property, free and clear from any trust declared in said trust agreement and free and clear of any right, claim, or demand of the defendants" (R. 106).

Of the assets thus returned to the decedent, about two-thirds never became the subject of any other *inter vivos* trust. On February 17, 1932, the decedent created a trust out of the remaining one-third, directing the trustee to pay the income to the decedent for life, and upon her death the income to Virginia Winslow Smith for life, and upon the latter's death to pay over the corpus to the two daughters of the decedent in equal shares (R. 144).

Upon the decedent's death in 1933, the Commissioner determined that the corpus of the 1932 trust should be included in her gross estate, in accordance with the provisions of Section 302 (c) of the Revenue Act of 1926, which had been recently twice amended (March 3, 1931, and June 6, 1932) to

cover specifically the case of a transfer with the reservation of a life estate to the transferor. This determination of the Commissioner was approved by the Board of Tax Appeals (R. 134–148). Upon appeal, the Circuit Court of Appeals agreed with the Government that it was the 1932 trust, rather than the 1927 trust, which formed the basis for the tax, but decided that the tax was nevertheless invalid since there was "an irrevocable, completed, *inter vivos* gift" before the decedent's death, and that therefore the value of the property comprising the trust should not be included in the decedent's gross estate (R. 170).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that Section 302 (c) of the Revenue Act of 1926, as amended by Joint Resolution approved March 3, 1931 (Pub., No. 131), and by Section 803 (a) of the Revenue Act of 1932, is contrary to and in violation of the Fifth Amendment to the Constitution of the United States.

2. In failing to hold that the corpus of the trust of February 17, 1932, is subject to Federal Estate Tax under Section 302 (c) of the Revenue Act of 1926, as amended by Joint Resolution approved March 3, 1931 (Pub., No. 131), and as further amended by Section 803 (a) of the Revenue Act of 1932.

3. In holding that the value of property transferred under an irrevocable deed of trust, under

the provisions of which the income from the property conveyed is reserved to the settlor for life, is not subject to the Federal Estate Tax under Section 302 (c) of the Revenue Act of 1926, as amended.

4. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The Circuit Court of Appeals, in holding invalid Section 302 (c) of the Revenue Act of 1926 as amended by the Joint Resolution of March 3, 1931, and likewise Section 803 (a) of the Revenue Act of 1932 (Appendix, *infra*), has decided an important question of constitutional law which calls for review by this Court.

From the beginning, the inclusion in the gross estate of decedents of transfers whereby the decedent retains for his life the possession of, or the income from, the property transferred has been regarded as an integral and necessary part of the estate tax. Prior to 1931 such transfers were regarded by administrative regulation as transfers "intended to take effect in possession or enjoyment at or after" the death of the transferor, within the language of the estate tax Act. See Regulations 37, Article 24; Regulations 63, Article 20; Regulations 68, Article 18; Regulations 70 (1926 ed.), Article 18. On May 2, 1931, however, this Court held in three cases that such transfers were not comprehended within the language of the statute.

Morsman v. *Burnet*, 283 U. S. 783; *Burnet* v. *Northern Trust Co.*, 283 U. S. 782; *McCormick* v. *Burnet*, 283 U. S. 784.[1] In each of these cases a *per curiam* opinion was delivered, stating that the question was one solely of statutory construction, "there being no question of the constitutional authority of the Congress to impose prospectively a tax with respect to transfers or trusts of the sort here involved * * *." 283 U. S. at 783, 784. On the day following these decisions Congress, upon the anxious suggestion of the Treasury Department, enacted the Joint Resolution here involved, amending Section 302 (c) of the Revenue Act of 1926 to include specifically transfers of the character here in question.

The prompt enactment of the Joint Resolution of March 3, 1931, was based upon a clear recognition of the importance of such a provision to a successful maintenance of the estate tax system. A letter from Ogden L. Mills, Acting Secretary of the Treasury, which was read in the House, stated (74 Cong. Rec., No. 7, p. 7198): "Without this amendment, the Federal estate tax will be seriously affected. It has been estimated that the effect of these Supreme Court decisions will be to cause a loss in excess of one-third of the revenue derived from the Federal estate tax, with anticipated refunds in excess of $25,000,000." The letter urged

[1] The decisions were on the authority of *May* v. *Heiner*, 281 U. S. 238. That case involved a transfer reserving an intermediate life estate to the grantor.

enactment of the resolution "in view of the character of these transfers and in order to prevent tax evasion."

The Chairman of the House Committee on Ways and Means, Mr. Hawley, expressed similar concern (74 Cong. Rec., Part 7, p. 7198):

> It had generally been considered that this provision of the statute covered cases such as those referred to above [*Morsman* v. *Burnet, supra; Burnet* v. *Northern Trust Co., supra; McCormick* v. *Burnet, supra*]. The Treasury Department had so construed the statute since the first Federal estate tax law in 1916 and its regulations so provide. * * *
>
> It is entirely apparent that if this situation is permitted to continue, the Federal estate tax will be seriously affected. Entirely apart from the refunds that may be expected to result, it is to be anticipated that many persons will proceed to execute trusts or other varieties of transfers under which they will be enabled to escape the estate tax upon their property. It is of the greatest importance therefore that this situation be corrected and that this obvious opportunity for tax avoidance be removed. It is for that purpose that the joint resolution is proposed.

The importance of the constitutional question which has been decided adversely to the Government by the court below is thus manifest.[2]

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[2] The court below rejected respondent's contention that the termination of the earlier trust constituted full consideration to the grantor for the execution of the new trust, holding that the earlier trust was invalid. Should respond-

2. The decision of the court below is not only contrary to what appears to be the implication of the language quoted above from the *per curiam* opinions of this Court, but is inconsistent with principles of estate taxation which have been repeatedly declared by this Court and which were reviewed and applied as recently as *Helvering* v. *City Bank Co.*, 296 U. S. 85. It is settled that Congress may classify with testamentary transfers, for estate tax purposes, *inter vivos* transfers which are in the nature of substitutes for testamentary disposition. And as an adjunct to the taxation of testamentary transfers, Congress may tax transfers *inter vivos* which would otherwise be employed as a method of tax evasion. *Helvering* v. *City Bank Co., supra; Milliken* v. *United States,* 283 U. S. 15; *Tyler* v. *United States,* 281 U. S. 497; *United States* v. *Wells,* 283 U. S. 102, 116–117. A transfer with a reservation of a life estate in the grantor was, perhaps, the commonest method of escaping state death taxes, and in the light of that

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ent's contention be renewed in this Court, we shall support the conclusion of the court below on this issue. If it should nevertheless be determined that the earlier trust was clearly valid, we shall maintain (a) that its termination did not constitute full consideration to the grantor, since the property conveyed in this earlier trust had remained part of the grantor's gross estate under an application of the Revenue Act of 1926 as amended; and (b) that such a retrospective application of the amended Act is not unconstitutional.

For present purposes, however, it is enough to observe that, unless reviewed, the decision below is a bar to the prospective application of the amended Act.

experience such transfers have generally been included in the measure of death taxes. See *Keeney* v. *New York*, 194 N. Y. 281, 287, affirmed, 222 U. S. 525. In the case of state death taxes such inclusion is valid beyond question. In *Guaranty Trust Co.* v. *Blodgett*, 287 U. S. 509, it was declared that prior statements of the Court sustaining the validity of such a tax under the Fourteenth Amendment express the "settled conviction of this court" (p. 513). The decision of the court below reaching a contrary result in respect of the Fifth Amendment is largely based, we submit, upon a misapplication of decisions which involved either retroactive taxation or questions of statutory construction. The decision below is thus in conflict with the *Guaranty Trust Co.* case, *supra*.

3. The Bureau of Internal Revenue advises that, if Congress is without power to include within the estate tax transfers of the sort here involved, the revenue from estate taxes during the present fiscal year will be reduced by approximately $45,000,000. It is impossible to estimate the amount of tax that will be involved in cases where the transferors are still living, but it is safe to say that it will be so large that the revenues of the Government will be seriously affected.

CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

AUGUST 1937.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

* * * * *

(c) (As amended by the Joint Resolution of March 3, 1931, c. 454, 46 Stat. 1516.) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, *including a transfer under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property, or (2) the right to designate the persons who shall possess or enjoy the property or the income therefrom;* except in case of a bona fide sale for an adequate and full consideration in money or money's worth. (U. S. C., Title 26, Sec. 411.)

(The language in italics represents the new matter added by the 1931 Amendment.)

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC 803. FUTURE INTERESTS.

(a) Section 302 (c) of the Revenue Act of 1926, as amended by the Joint Resolution of March 3, 1931, is amended to read as follows:

"(c) To the extent of any interest therein of which the decedent has at any time made

a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title." (U. S. C., Title 26, Sec. 411.)

* * * * *

Treasury Regulations 80:

ART. 18. *Transfers with possession or enjoyment retained.*—(a) *Transfers included.*—The statutory phrase, "a transfer * * * intended to take effect in possession or enjoyment at or after his death", includes a transfer, whether in trust or otherwise, made subject to the reservation by the decedent of the use, or the possession, or the rents or other income of the transferred property, or any part thereof, for his life, or for a period ascertainable only by reference to his death, or for a period of such duration as to evidence his intention to

retain the enjoyment (in whole or in part) of the transferred property throughout his life. (See article 15.)

(b) *Taxability.*—Every such transfer (not amounting to a bona fide sale for an adequate and full consideration in money or money's worth), made by the decedent subsequent to September 8, 1916, is taxable, and the value of the property or interest so transferred shall be included in the gross estate of the decedent. The provisions of this subdivision do not apply (1) if the transfer was made prior to 10:30 p. m., eastern standard time, March 3, 1931, and (2) if the decedent died prior to 5 p. m., eastern standard time, June 6, 1932. See section 506 of the Revenue Act of 1934.

U. S. GOVERNMENT PRINTING OFFICE: 1937